DOW THEORY LETTERS INC.

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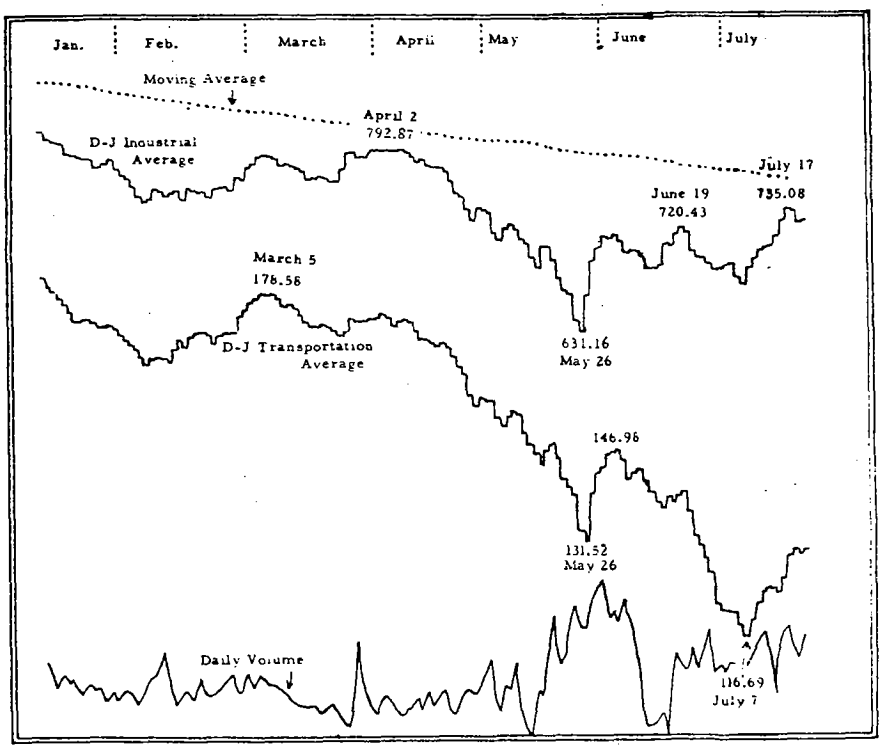
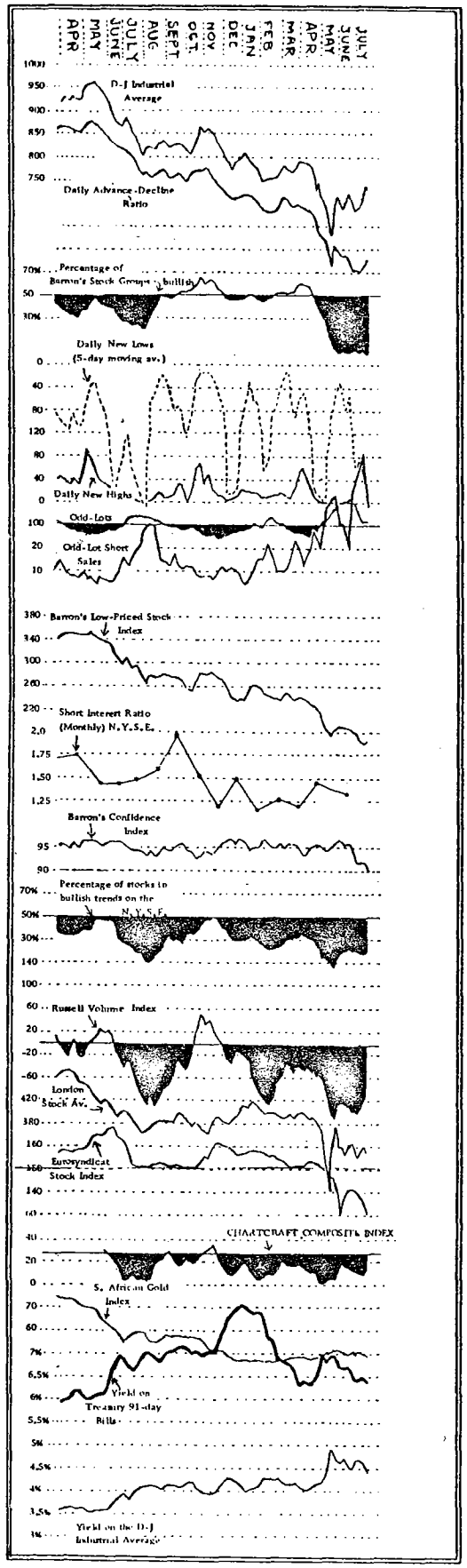
THE MARKET: Backed by a massive and bullishly-oriented propaganda barrage, the D-J Industrial Average has pushed more than 100 points above its May 26, 1970 low of 631.16. While the Democrats point to the possibility of a $12 billion plus budget deficit and a continuation of inflation pressures, the Republicans proudly hold forth a miniscule rise in Gross National Product for the latest month, a jump in housing starts, a rise in personal income, and a drop in interest rates across the board. Much is being made of early second quarter earnings, although it is a fact that the best reports seem to come "early", and little or nothing is said regarding the two-phase elimination of the 10% surtax (which automatically boosts earnings). The "semi-panic" regarding the Penn Central and I.O.S. fiascos have been forgotten, although nobody yet knows how these two debacles will be handled.

Few comments are forthcoming regarding the contraction of the $40 billion commercial paper market as borrowers here and in Europe turn away from corporate paper following the recent series of corporate bankruptcies. But the growing preference for high quality was documented this week as Barron's Confidence Index (the ratio of the yield on the highest grade to the medium grade bonds averages) dropped to 90.1, lowest reading since 1963.

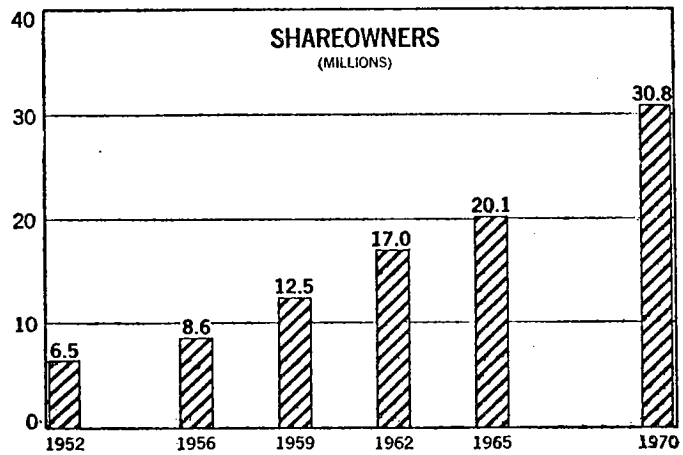
Today a friend walked into the office and said, "You know, I was just going over this week's charts and its amazing how few stocks on either exchange have really lifted off their lows!" And any subscriber who has a chart book can easily verify that observation. The rally so far has been largely a "super blue-chip" rally with the thirty Dow stocks and their "cousins" carrying the ball. Meanwhile, the secondary, lesser quality and Amex Exchange issues have, in many cases, hardly budged off their May-July lows. In fact, despite




D-J Industrial Average
Daily Advance-Decline Ratio
Percentage of Barron's Stock Groups bullish
Daily New Lows (5-day moving av.)
Daily New Highs
Odd-Lots
Odd-Lot Short Sales
Barron's Low-Priced Stock Index
Short Interest Ratio (Monthly) N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on the N.Y.S.E.
Russell Volume Index
London Stock Av.
Eurosyndicat Stock Index
CHARTCRAFT COMPOSITE INDEX
S. African Gold Index
Yield on Treasury 91-day Bills
Yield on the D-J Industrial Average

the Dow advance, the Amex Index has literally moved sideways since June. Thus, the great majority of stockholders have been left at the start by this rally, neither showing profits nor recouping their losses. In effect, this bear market has been correcting itself while letting as few people as possible off the hook. It's been an incredible performance, and the frustration to the average investor must be very great indeed.

ncidentally, speaking of the average investor, the latest official computation shows that there are now 30.8 million shareholders in the U.S., highest in history (see chart). This is five times the number of shareholders existent in 1949, when the great bull market of 1949-66 began. Thus, whereas 5-6 million holders were in at the beginning of the bull market and participated in the great ride up, 28-30 million shareholders have been in on the worst bear market since the 1930's, and are participating in losses on the way down. That figure of 30 million strikes me as a very important statistic. It's difficult to believe that all those 30 million people will be around holding stock certificates when the next true, primary bull market begins.



Over the past few weeks I have been besieged by letters asking whether this is the time to buy. Readers tell me that all their banker, broker and investor friends are insisting that with many stocks down 50% to 90%, this is "the opportunity of a lifetime to grab bargains." What can I say? I write what I believe in these reports, and nobody's banker or broker friends are going to convince me that with 30 million shareholders now in the market and with every banker, broker, analyst and columnist talking about bargains, the bear market is over. At the true bottom of the bear market, I believe these same friends will not want to talk or hear about Wall Street, and I further believe that there will be nearer 10 million shareholders than today's 30 million.

In the last Letter I stated that an intermediate or secondary bullish signal would be given if Industrials and Transports bettered their June peaks of 720.43 and 146.98 respectively. On July 16 the Industrial Average (by bettering 720.43) gave one-half of a bullish signal. Transports, however, were far below their comparable June peak (see page 1 chart). As the great Dow Theorist, Robert Rhea, so often noted, valid indications can only be given by penetration of previous points by both Averages. A penetration of a single Average, while "hopeful" on the face of it, is useless for predictive purposes and may very likely be deceptive. A single penetration, in other words, is no better than none at all. And that's where we stand as of this writing.

No one knows what hopes and bullish sentiments the current Administration may be able to stir up between now and election time, and no one knows what unforeseen difficulties may arise in the monetary, business or political arenas. By my interpretations, we are still very definitely in a primary bear market, and this means that those who buy or hold stocks here are rowing against the tide. I don't recommend running up down-escalators, I don't recommend spitting into the wind, I don't recommend building a home on the water's edge during low tide. And I don't recommend buying stocks during the beginning, middle or end of bear market rallies no matter how weak or powerful the rally.

NEW INDEX FOR PAGE 1: If you will look towards the bottom of the narrow composite chart on page 1 you will see a new Index labeled "Chartcraft Composite Index". This will take the place of the Merkle Index from now on. Chartcraft has been keeping a library of many technical indicators for years. In May, 1969, Chartcraft came out with their "Indicator Review," the latest copy of which is shown at the right. Here we see 28 indicators, and each of them is kept on a point & figure basis by Chartcraft and up-dated each week. Here is how the index is tabulated. If an indicator is in an uptrend (signified by an X on the P & F chart) it is scored 1. If the indicator is technically bullish in that the column of X's has bettered the preceding column of X's, it is scored 2. If the indicator is in a decline (which shows on a P & F chart as a vertical line of O's) it is scored zero. As an example, I am showing the latest ASE/NYSE volume index (this is a ratio), and the score here (since the last line is a bearish or vertical line of O's) is zero.

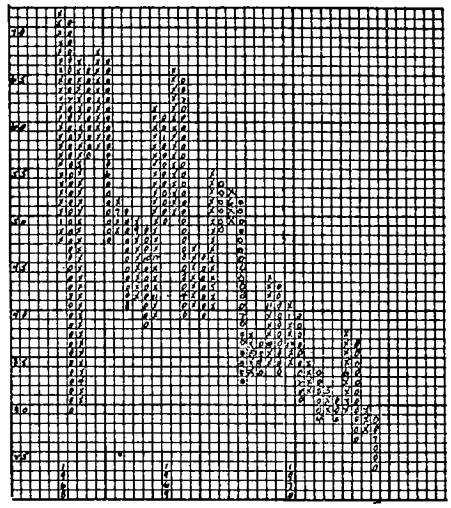
Each week the total of all 28 indexes (as scored, bullishly or bearishly) is computed by Chartcraft. The lowest possible figure would be zero, meaning that all trends in all 28 indicators would be bearish. The highest possible figure would be 56, which would mean that each of the 28 indicators would have scored a 2.

INDICATOR REVIEW

Dow-Jones Industrial Average	1
Dow-Jones Transportation Average	1
Standard & Poor's "500"	1
New York Stock Exchange Average	1
American Stock Exchange Average	0
Advance-Decline Line	1
High-Low Index	0
Odd-Lot Balance Index	1
Odd-Lot Short Sales Index	1
On-Balance Volume Index	2
Upside Volume Index	0
Market Disparity Index	0
200-Day Momentum Index	1
Dow-Jones 2nd Grade Rail Bonds	0
Barron's Confidence Index	0
Money Supply	0
Index of Speculative Confidence	0
Gold Mining Disparity Index	0
DJIA One-Year % Chart	1
ASE/NYSE Volume	0
NYSE Bullish Percentage	0
ASE Bullish Percentage	1
DJIA Bullish Percentage	1
Industry Group Bullish Percentage	0
Short Interest Ratio	1
NYSE Seat Price	0
Price/Dividend Ratio	0
Bond/Stock Ratio	2
	16

The halfway point or neutral level of the index is 28, and I have marked all index figures below 28 with a solid black area on the page 1 chart. The latest index reading was 16, and the chart is tabulated up to date. I have been struck by the logic, value and accuracy of the Chartcraft Composite Index, and last week Mr. A.W. Cohen, editor of Chartcraft, kindly gave me permission to include this index in each issue of Dow Theory Letters. I feel that the Chartcraft Index will be well worth following.

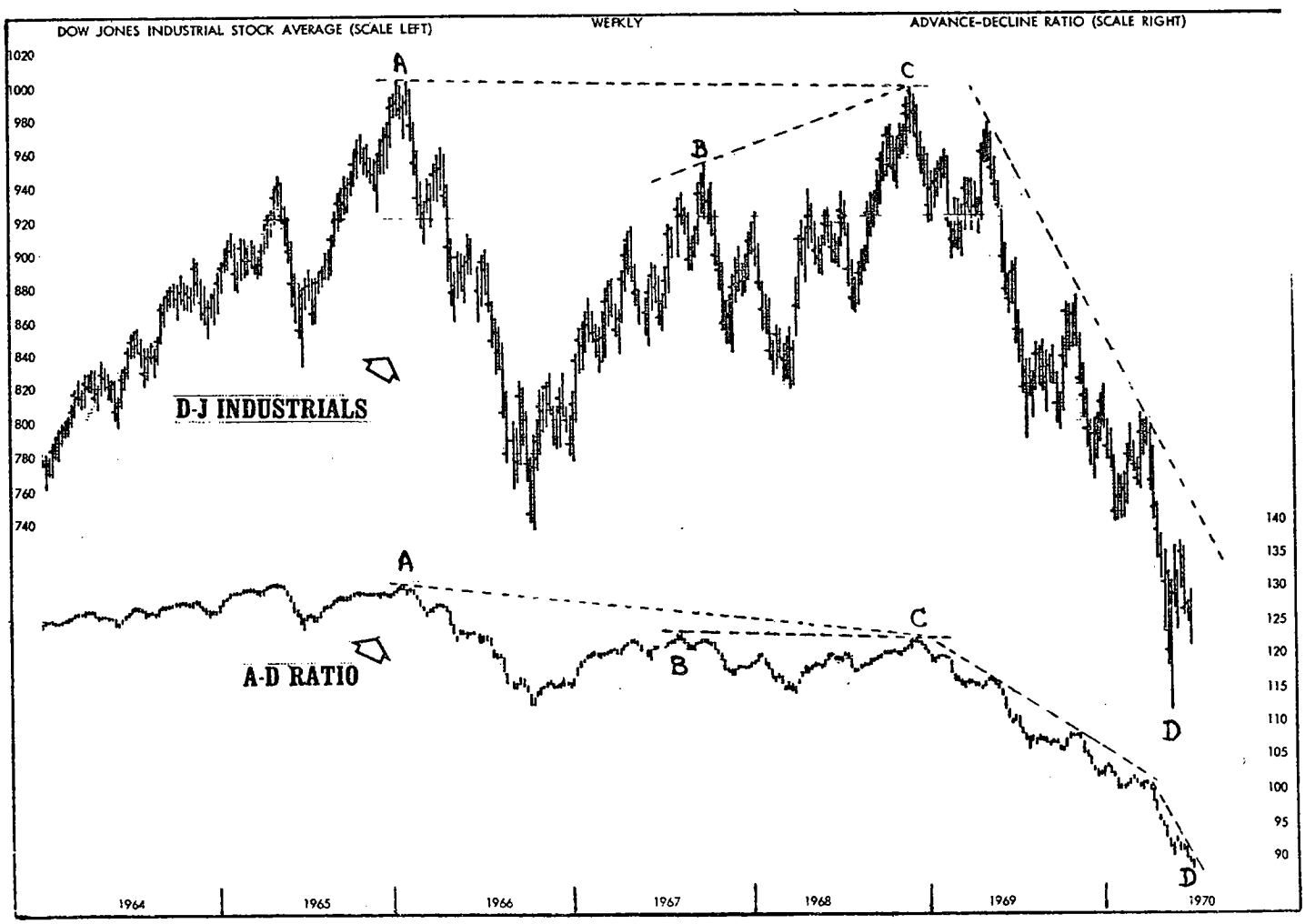
ASE/NYSE VOLUME



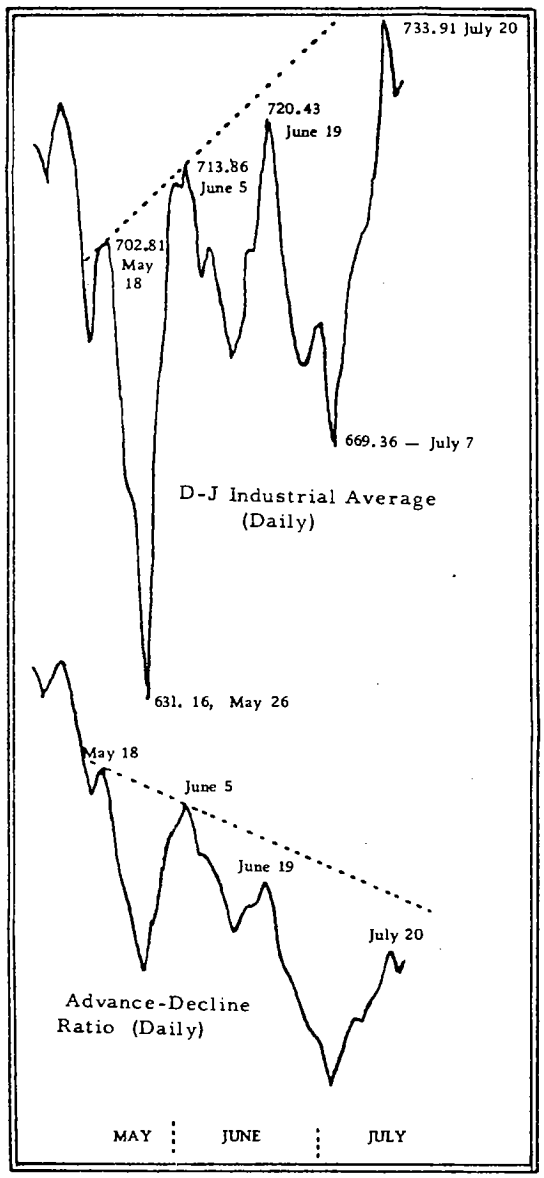
PRICE AND BREADTH: I show here a long-term weekly chart of the D-J Industrials and the advance-decline ratio (chart courtesy of Traders Research). What we see here is a steadily weakening situation in the advance-decline ratio, with that weakness becoming more pronounced as the bear market continues. This is in line with major bear market characteristics. For it should be remembered that the 30 Dow stocks that make up the average include some of the best managed companies in America, giant, powerful companies. In fact the 30 Dow companies comprise about one-third of the value of all issues listed on the N.Y.S.E.

As the bear market progresses, the pressures of adverse business conditions (for instance, high interest rates, liquidity problems, inferior sales and distribution and in many cases inferior or less diversified lines) exert more force on the less powerful companies. In other words, in rough times the 30 Dow stocks can be expected to out-perform the great majority of stocks listed on any of the Exchanges.

The advance-decline ratio measures the advancing or declining tendencies of the majority of stocks. Therefore, it is always of vital interest to compare what is happening to the majority vs. what is happening with the 30 giants. The chart provides the answer. At point C, the Dow failed to equal the 1966 (A) peak by a mere 10 points. But the A-D ratio at C failed by a wide margin to equal its 1966 peak at C. At the recent lows (D) the A-D ratio had broken far below the 1962 bottom. At point D on Industrials (631.16), the senior Average had not pushed even close to its 1962 low of 535.76. The inference is that



a majority of stocks had fallen close to or below their 1962 lows, even while the 30 Dow stocks resisted the debacle.



Past history suggests that the A-D ratio leads in the primary direction during bear markets. I believe it is doing that now. The weakness in the ratio has become more pronounced during June and July than at any other time since the bear market began. That phenomenon is discussed in the next section.

PRICE & BREADTH -- 2: I show on the accompanying chart the daily action of the D-J Industrials and the A-D ratio since early May, 1970. What we see here is a remarkable series of non-confirmations (a continuing "divergence") beginning with the period following the joint May 18 peaks. If you will refer back to Letter 465 (June 24), you will note that I drew careful attention to the series of three ascending peaks in the Dow together with the three descending peaks in the A-D ratio. This divergence was followed by a 51 point plunge in the Dow to the July 7 low of 669.36.

Following the June-July drop, the Dow rallied strongly, and by July 20 the senior Average had advanced to a new recovery high of 733.91. As seen on the chart, this new high served to add another non-confirmation between the Dow and the A-D ratio, making the series an extraordinary four ascending peaks on the Dow and four descending peaks on the A-D ratio.

On July 22 the Industrials suddenly dropped 11.84 points, as the technical problem of two months of price-breadth non-confirmations again took hold of the market. Ultimately, the trend of the Dow and the A-D ratio must get "in gear". This technical "must" will be resolved either by a rise of both indicators with the A-D ratio bettering first its July 20, then its June '9, then the June 5 peak.....or a plunge by both indicators to new ear market lows. Past history suggests that in cases of extended price-breadth divergence, the Dow resolves the problem in favor of the direction of the A-D ratio.

I want to add that in my reading of dozens of other investment services, I am amazed by the almost total absence of reference to the current price-breadth divergence.

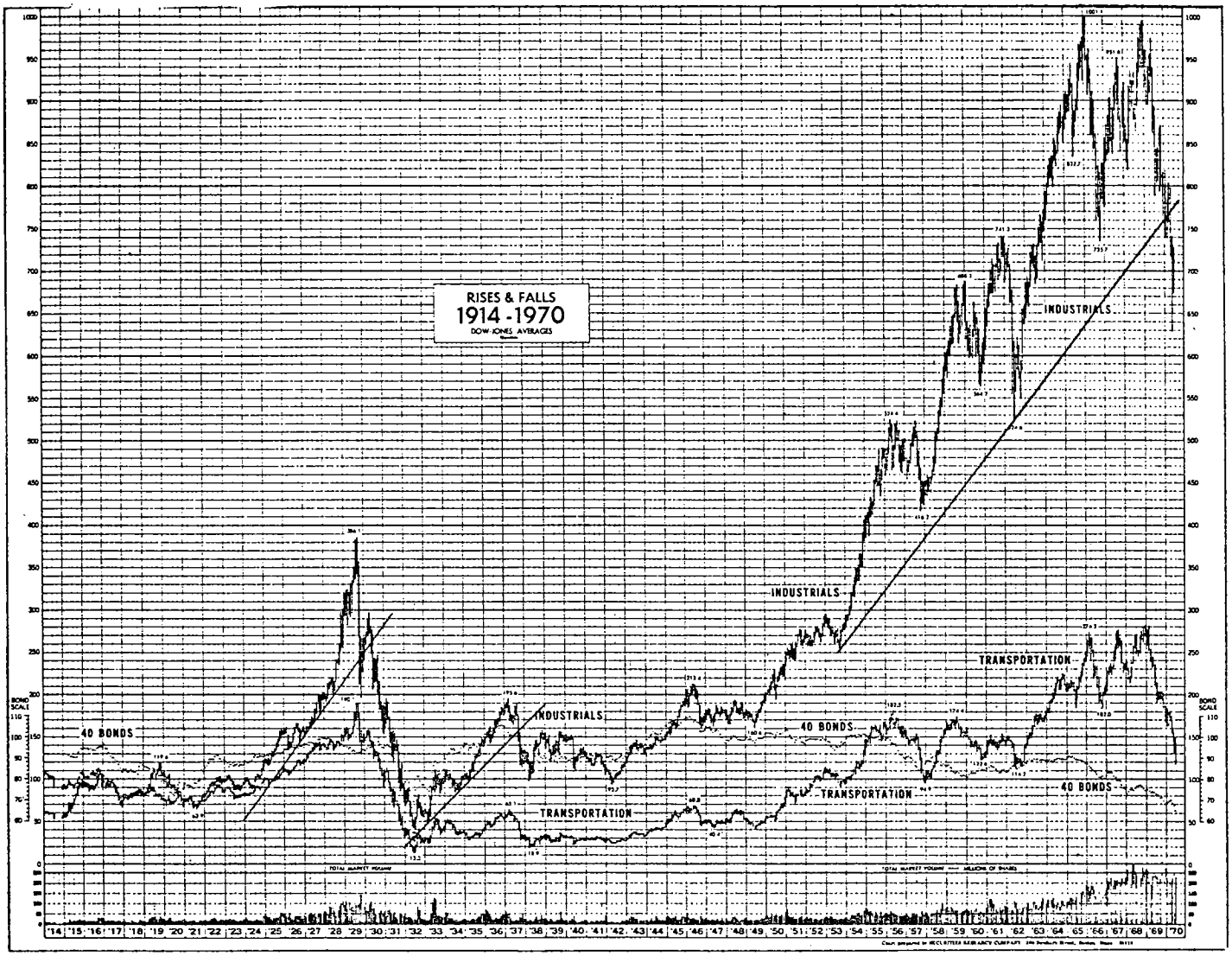
LONG TERM: I am reproducing an excellent long-term monthly chart (page 5) published by Security Research, 208 Newbury St., Boston, Mass. 02116. I have drawn trendlines which trace the major upward thrust of three important primary bull markets, 1921-29, 1932-37 and 1949-66. These three bear markets represent the three worst collapses in security values since the early 1900's.

Now, history doesn't have to repeat, and no two bear markets will ever be exactly the same. But I think it is important to note what occurred during the two previous primary bear markets after the major rising trendline of the previous bull market was broken.

Starting with the 1929-32 bear market, it was not until mid-1930 that the Dow fell decisively below the trendline and plunged toward the 1932 lows. Taking the period after the decisive 1930 downward penetration of the trendline, it took 27 months before the Dow touched its final bottom. In other words, the bulk of the bear market decline occurred after the Dow dropped decisively below the trendline (I am not using the first or late-1929 penetration as the Dow pushed temporarily back above the trendline during early 1930).

Now turning to the trendline which contained the bull market of 1932-37, this trendline was decisively broken in late-1937. The Dow touched its 1938 low of 98.95 six months later. The Dow then pushed into the 150 area during 1938 and again during 1939. During 1940 the whole advance was wiped out and the final low was recorded in 1942 at 92.92.

Finally, we have the trendline of the 1949-66 bull market, the trendline which connects the 1953 and 1962 bottoms. It may come as a surprise to most to learn that only four months have elapsed since this trendline was decisively penetrated on the downside. But already, many people are proclaiming that the "worst has been seen," and that "the bear market is over". Of course there is no way



in which that argument can be definitely refuted at this time. The market can do anything, and it is certainly within the realm of possibility that the primary bear market ended at 631.16 for the Dow. But aside from the fact (which I have repeated many times here) that no important indicationsof a bear market bottom have presented themselves so far, we have the previous examples of 1929-32 and 1937-42 to ponder upon.

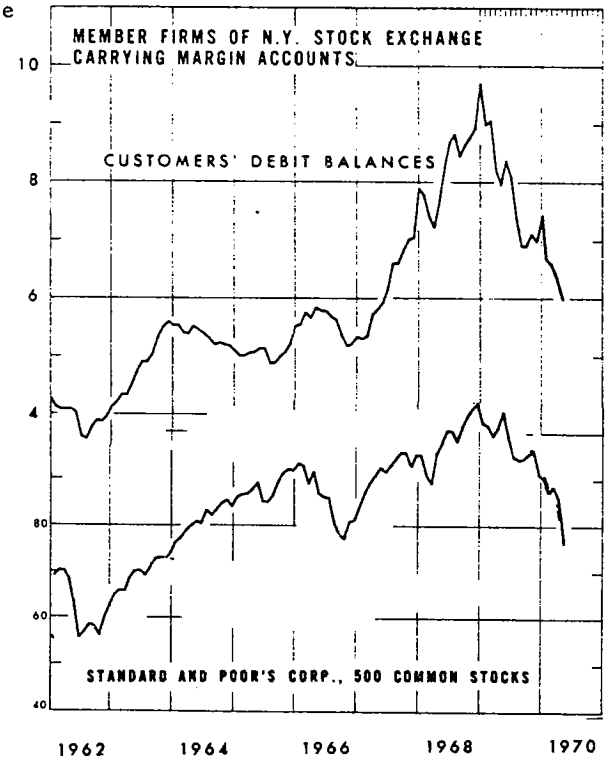
The odds are that the plunge which ruptured the great 1949-66 bull market trendline was not exhausted four months after the trendline penetration. The odds are that the force which propelled the Dow through that trendline was not exhausted when the Dow (in May) sank 20% below that trendline. What I am saying is that I do not feel that four months after the penetration, with the Dow at 631, the force of the bear market was dissipated. I will admit that this is an "instinctual" or "seat-of-the-pants" observation, and time will tell if I am right or wrong. But the odds, based on past cases, suggests that this bear market has much longer and much farther to go on the downside.

EXIT: When the speculator purchases stocks on margin, he receives a debit balance in his account. During a bull market, debit balances (and by implication, margins) tend to build up. Therefore, as my friend Dr. Sloan Wilson pointed out in his book, "The Speculator and the Stock Market," the steady rise in debit balances during a bull market is a bullish indication. It means that the speculator (using his margin account) is taking an increasingly bullish view of the market and is confident enough to assume an increasingly large margin position.

As seen on the page 6 chart (from the Federal Reserve Chart Book), the debit balances built up steadily during the 1960's to a late-1968 peak of almost $10 billion. Dr. Wilson noted, however, that during a primary bear market the whole debit process works in reverse. As a bear market progresses, more and more speculators leave, either because they give up on the market or because they have been wiped out.

The build-up of debits during a bull market and the decline of debits during a bear market is what Dr. Wilson termed the "round trip" phenomenon. Further, Dr. Wilson noted that by the time a major bear market ends, the level of debits is usually back to the approximate area at which the preceding bull market started.

The chart shows the massive decline in debits since 1968, from almost $10 billion to around $6 billion today. The implications are clear. The speculator, the man on margin, is being slowly squeezed out of this bear market. If Wilson's observations regarding previous bear markets are fated to repeat during this bear market, then we can expect the round trip phenomenon to run full course. In that case, it would not surprise me to see debits fall to below $1 billion or thereabouts before the bear market is over. For $.5 billion is the approximate level of debits when the preceding bull market began in June, 1949.



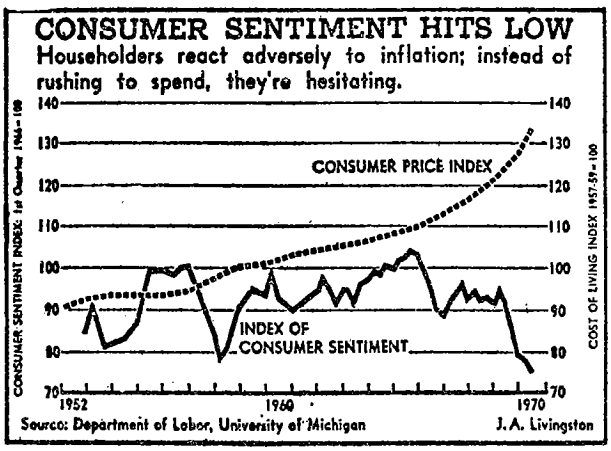
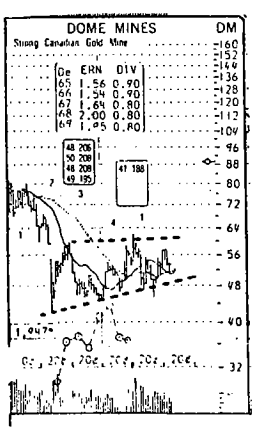
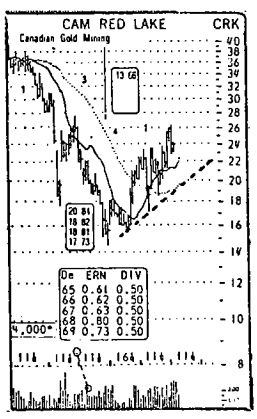
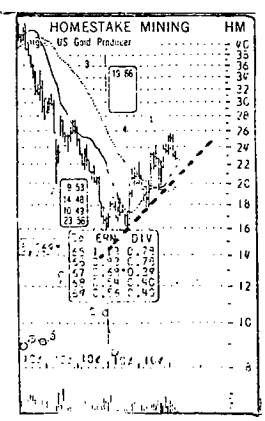


CHART OF THE WEEK: The latest survey by the University of Michigan indicates that the American consumer's intention to buy has touched its lowest point since 1952. Superimposed on the chart is the consumer price index, which on latest count, was heading upward at an annual rate in June of 4.8% (which exactly matched the May rate). Thus the biggest inflationary spiral of the last 20 years continues. It should be remembered that at 4.8%, inflation would wipe out almost half the current purchasing power of the dollar within ten years. The dilemma for the Administration is both awesome and obvious. If holding back the money supply slowed the inflation rate only slightly but put the skid on business, what will the current expansion of the money supply do to the inflation rate over coming months? It seems to me that the Administration is willing to gamble on more inflation, at least until election times, if it can only get business expanding again. Secondly, the Administration is aware of the huge potential Federal deficits ahead, and is trying to cut back sharply on that mountainous spending inferno known as the defense budget. Meanwhile, the consumer, racked by inflation and rising expenses, is intending to buy less. It's quite a mixture. Maybe the answer, as Bob Dylan would put it "is blowin' in the wind".







GOLDS: These weekly charts of the three leading listed gold mining shares are courtesy of Quote Digest, 403 N. Main St., Wichita, Kansas 67202. They show that ever since the mid-1969 lows, the gold shares have been building potential bases. In the case of Homestake and Campbell Red Lake, these two issues are up over 50% from their 1969 lows. I would recommend new or additional purchases of Campbell on any correction to or near its rising trendline (which is now about 20).